

CHAPTER 4

LOCAL PROPERTY TAX

HIGHLIGHTS

- Tax Base Assessed value of real property (land, improvements, and fixtures) and tangible personal property (equipment, machinery, office furniture, etc.).
- Tax Rate Maximum 1% countywide rate on assessed value of property, proceeds of which are distributed to all local agencies within the county pursuant to statutory formula. Individual agencies may levy rates above the 1% maximum to service voter approved debt.
- Revenue

| | |
|--------------------|-----------------|
| 2006-07 | \$43.2 billion* |
| 2007-08 (Estimate) | \$46.9 billion* |
| 2008-09 (Estimate) | \$49.2 billion* |
- Administration County Assessors and Board of Equalization (BOE)

Includes basic 1% rate; excludes reimbursement by the state to local governments.

*Source: BOE

1. TAX OVERVIEW

The **property tax** is the major general revenue source for local governments in California. It is imposed on the property owners and is based on the value of the property (thus it is often referred to as an ad valorem tax). However, since the adoption of Proposition 13 in 1978, real property has generally been taxed based on its value at the time of its acquisition, with increases for inflation limited to 2% per year. Liability is for a fiscal year (July 1 to June 30) or a portion thereof. Payments are made in one or two annual installments.

The property tax applies to all classes of property -- residential, commercial, industrial, agricultural, open space, timberland, and vacant land. Special rules apply to some kinds of property, such as certain agricultural land and timberland. Public land is generally exempt. Property taxes are collected by the county and distributed to local agencies within the county based on a statutory formula.

2. FOUNDATIONS OF PROPERTY TAX LAW

Much of the law pertaining to taxation of property is prescribed in the California Constitution -- in Article XIII, which was part of the original California Constitution, and in Article XIII A, which was adopted by the voters of the state as Proposition 13 in 1978.

Most fundamental modifications to property tax law must be made by constitutional amendment approved by the voters of California. The Legislature is authorized to implement and modify various aspects of property tax law and is authorized by the Constitution to exempt personal property by a two-thirds vote.

Judicial decisions play an important part in the evolution of property tax law, as lawsuits are brought to resolve disputes over the meaning of various constitutional and statutory provisions. The U.S. Supreme Court upheld the constitutionality of Proposition 13 in 1992, finding that it does not violate the U.S. Constitution's equal protection or right to travel provisions.

3. WHO MUST PAY THE PROPERTY TAX

In most cases, the owner of the property is assessed for the property tax. In cases where the owner leases the property to someone else, the assessor may assess either the owner, the lessee, or may make a joint assessment on both the lessor and lessees. However, the owner is ultimately liable for payment of the tax.

In one special circumstance, a non-owner of property is assessed for the property tax. This occurs when an individual or business has the right to use tax-exempt land. The most common example is the case of government-owned property that is leased to a private party. The lessee holds what is called a "possessory interest" in the property, and is assessed for property taxes on the property. Examples of taxpayers who have possessory interests are owners of cabins on national forest land, ranchers with grazing rights on federal lands, aircraft operators using government-owned airports, cable television companies laying cable in publicly owned streets, and shipping companies renting berths in county-owned ports.

4. TYPES OF PROPERTY SUBJECT TO TAX

The Property Tax Base. The property tax base is composed of two major categories of property: Real property and tangible personal property.

Real property includes land, permanently attached improvements (such as buildings, swimming pools, and other structures), fixtures (items that are permanently affixed to structures, such as air conditioning units, lighting fixtures, permanently installed machinery, etc.), and mineral rights.

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Tangible personal property includes movable property such as equipment, portable machinery, office furniture, vessels, and aircraft.

Some of the major types of property that are not part of the property tax base include property owned by government or certain charitable organizations, intangible property (e.g., stocks and bonds), household personal property, automobiles and trucks, and business inventories. These are described more fully in the exemption section below (Section 12).

State-Assessed Versus Locally-Assessed Property. Assessment of property involves placing a value on that property for purposes of property taxation. All real and personal property is classified as either locally-assessed property or state-assessed property, depending on which level of government is responsible for assessment.

The assessor of each county is responsible for valuation of locally-assessed property. Most property is locally-assessed.

The BOE is responsible for valuation of state-assessed properties. State-assessed properties include utility and railroad property, private railroad cars, inter-county pipelines, flumes, canals, ditches, and aqueducts. Generally, state-assessed properties operate as an integrated unit and often cross county boundaries. These properties are sometimes called "unitary" properties.

Unitary property is assessed as an operating unit because the separate parcels in each county have little independent value. For example, it makes little sense to value one section of railroad track; its value depends on being a part of an integrated system. Therefore, the BOE values all of the state-assessed property holdings as a single unit and allocates the value among the counties.

Secured and Unsecured Property Tax Assessment Rolls. All property is accounted for on property tax assessment rolls maintained by each county assessor. The property tax assessment rolls contain an entry for each parcel of land, including the parcel number, owner's name, and assessed value. This information may also be stored electronically, rather than a physical document. There are two kinds of property tax rolls. Property is entered on one or the other, based on how certain the county is of being able to collect taxes if they become delinquent, as described below.

Most property is on the secured roll. The secured roll consists of property for which the payment of tax is "secured" by a lien on real property owned by the taxpayer in that county. This means that the county could seize and sell the real property to satisfy the liability if the taxes become delinquent.

Generally, all real property for which the owner or possessor holds title is on the secured roll. Personal property can also appear on the secured roll if its owner also owns real property in the same county that can secure the personal property. All state-assessed property is also entered on the local secured roll. This portion of the secured assessment roll is sometimes referred to as the "Board roll".

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The unsecured roll consists of personal property of taxpayers that do not own real property in the county on which a lien can be placed to secure eventual payment if the property tax becomes delinquent.

Thus, the unsecured roll consists primarily of personal property and machinery and equipment owned by businesses that lease, rather than own, the real property they occupy. Generally, possessory interests in real property will be placed on the unsecured roll if the holder of the interest does not own other real property in the same county on which a lien can be imposed. Airplanes and boats are also on the unsecured roll.

The main difference in the treatment of property on these two rolls is that secured property taxes are payable in two installments, no later than December 10 and April 10, while unsecured property taxes are payable in one installment due no later than August 31. This earlier due date for unsecured roll tax payments is intended to assure collection of taxes on property that is more mobile.

5. TAX RATE

The provisions of Proposition 13, California Constitution, Article XIII A, limit property tax rates. Local property tax rates are composed of two parts:

- The basic countywide rate is limited to a maximum of 1%. Local agencies are permitted to adopt lower rates that can result in a countywide rate of less than 1%. The proceeds of the basic countywide 1% tax rate are general revenues allocated to local agencies within the county by statutory formula; and
- Local agencies within each county are permitted to levy additional tax rates for debt. The vote requirements were simple majority prior to Proposition 13 and generally two-thirds after approved by voters in June of 1978. However, pursuant to Proposition 39 passed by the voters in November 2000, bonded indebtedness incurred by a school district, community college district, or county office of education for the construction, reconstruction, rehabilitation, or replacement of school facilities may be approved by 55% vote after November 7, 2000. The proceeds of each additional debt rate are allocated to the local agency that received voter approval to incur the debt, and are earmarked for payment of principal and interest on that debt.

The California Supreme Court ruled that additional tax rates imposed to fund employee pension systems approved by the voters prior to July 1, 1978, are valid debt rates under Proposition 13 [*Carman v. Alvord* (1982)]. The Legislature codified permissible purposes for which additional rates may be levied as qualified indebtedness and placed limits on increases in additional rates for certain types of pension system debt.

As a result of the levy of additional rates for voter-approved debt, tax rates may vary from area to area within any county, depending on the number and amount of debt rates

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levied by the local agencies. For example, a resident of one area may pay a 1.1% rate (composed of the 1% countywide rate, a 0.05% rate for school district debt and a 0.05% rate for park district debt), while a resident of another area of the county may pay a 1.2% rate (composed of the 1% countywide rate, a 0.10% rate for a different school district's debt and a 0.10% rate for a water district debt).

The California Constitution provides that the tax rate applicable to the unsecured roll is the prior year's secured roll tax rate. This is because the unsecured roll bills are sent out early in the fiscal year, often before local agencies set the tax rate for the current year. Although counties have the authority under Proposition 13 to set the basic countywide tax rate below the maximum rate of 1%, in most cases the basic tax rate generally does not change. However, the additional debt rates change annually, based on revenue needs to meet principal and interest obligations. Normally the variation in debt rates from year to year is not great, so the impact on an individual tax bill is not pronounced.

6. PROPERTY VALUATION UNDER PROPOSITION 13

Valuation of property is a key factor in property taxation, since the tax rate is applied to the taxable value of the property (formally referred to as the 'assessed value' or 'full value') to determine taxes due. For example, a property with an assessed value of \$115,000 in an area where the total rate is 1.1% will have a property tax liability of \$1,265, computed as follows:

$$\$115,000 \text{ assessed value} \times 0.011 \text{ tax rate} = \$1,265 \text{ tax}$$

Proposition 13 sets forth rules controlling the valuation of property for property tax purposes. The Supreme Court has ruled that these provisions apply to the valuation of locally-assessed real property only, and does not apply to state-assessed property.

Value Standards: Fair Market Value and Acquisition Value. Under pre-Proposition 13 law, locally-assessed real property was assessed each year using a current market standard. Fair market value, which was determined annually by the county assessor, is the value for which the property would sell if offered on the open market.

Proposition 13 subjected locally-assessed real property to a new set of valuation rules, often referred to as the "acquisition value" standard. This system has several components as provided by Proposition 13 and implemented by statute, as described below:

- For purposes of moving from the old to the new system, Proposition 13 first required property values to be rolled back to the 1975-76 fiscal year (FY) fair market value level for the FY 1978-79. Properties that have not sold or undergone new construction since FY 1975-76 have a FY 1975-76 "base year value".
- A property's base year value is adjusted upwards each assessment year to reflect inflation as measured by the California Consumer Price Index, but not

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in excess of 2% annually. This process continues as long as the property is not subject to an ownership change or new construction. This value is known as the "factored base year value". This system is sometimes described as an "acquisition value" based system. The term "acquisition value" refers to basing future assessed values on the value of the property at the time it was originally acquired. The constitutional validity of this feature of Proposition 13, which often results in different tax burdens for similar properties, has been upheld by the U.S. Supreme Court.

- When a property is sold, transferred, or subjected to any other change in ownership, the property is reassessed to current fair market value as of the date ownership changed. Newly constructed property is also assessed at current fair market value as of the date of completion.
- The fair market value assessment at the time of new construction or change in ownership becomes the property's new "base year value", which is thereafter adjusted upwards by no more than 2% annually, until such time as another change in ownership occurs.
- If new construction occurs on only a portion of a property (for example, a room addition), the newly constructed portion is given a new base year value, and the pre-existing portion retains its old factored base year value. A property can have multiple base year values due to new construction until the whole property changes ownership, when it will be assigned a new base year value based on its total fair market value at the time of sale.
- If on any lien date (January 1) the market value of a property declines below its (base year value) factored base year value, it may be reassessed to reflect the lower value for that upcoming fiscal year. However, if the market value of the property recovers each following lien date after it is reassessed downward, the county assessor may increase the value of the property to its current market value for the next fiscal year. However, any property that is reassessed in this way may not be given a value that is greater than its factored base year value.

Three types of locally assessed real property are not subject to this valuation system. These are agricultural and open space land, timberland, and historical properties. Special valuation rules, described in Section 10, Preferential Assessment of Certain Properties, cover these properties.

Purchase Price Assumed to Represent Fair Market Value. Current law provides that when establishing value upon a change in ownership, the assessor should trust the purchase price represents fair market value, unless there is evidence that the property would not have transferred for that price in an open market transaction. If the assessor believes the property's fair market value is different from the purchase price and the property owner appeals the valuation, the assessor must demonstrate why he or she used

another value, generally by presenting comparable sales. The requirement to use the actual purchase price paid as the fair market value is sometimes referred to as "Rule 2", because the concept was originally adopted as a rule by the BOE. It has since been codified in statute.

Exemptions From Reassessment Upon Change in Ownership or New Construction.

Constitutional amendments adopted after Proposition 13 and statutory interpretations have permitted several exclusions from fair market value reassessment at the time of change in ownership or new construction. Six of the most significant include:

- Intrafamily Transfers. Under Proposition 58 of 1986, transfers of property between spouses are not considered changes in ownership. This proposition codified previously enacted legislation. In addition, Proposition 58 provided that transfers of principal residences plus transfers of up to \$1 million of other property between parents and children are not subject to reassessment upon change in ownership. Proposition 194 of 1996 extended the provisions of Proposition 58 to transfers between grandparents and grandchildren if the parents of those grandchildren are deceased.
- Replacement Residences of Senior Citizens. Under Proposition 60 of 1986, senior citizens may transfer the factored base year value of their original residence to a replacement principal residence, if the replacement is of equal or lesser value and located in the same county. Under Proposition 90 of 1988, the same relief is available for moves between counties if the county board of supervisors where the replacement home is located has adopted an ordinance permitting the transfer of value.
- Replacement Residences of Disabled Persons. Under Proposition 110 of 1990, severely and permanently disabled persons meeting specified requirements may transfer the base year value of an original dwelling to a replacement dwelling of equal or lesser value without triggering reassessment.
- Seismic Safety Improvements. Under Proposition 127 of 1990, specified seismic retrofitting and earthquake hazard mitigation technologies applied to existing buildings are not subject to reassessment as new construction.
- Environmental Contaminations. Under Proposition 1 of 1998, property acquired or reconstructed as a replacement for property destroyed as a result of environmental contamination cleanup activities may be excluded from fair market value reassessment.
- Transfers by and between Registered Domestic Partners (RDPs). Under SB 565 (Migden), Chapter 416, Statutes of 2005, transfers of real property between RDPs or former RDPs are excluded from changes of ownership. In addition, transfers to trusts at death and in connection with property settlement upon the dissolution of a RDP are not considered changes of ownership that

subject the real property to reassessment.

Other allowable exclusions from reassessment include:

- Property reconstructed after a disaster;
- Property acquired to replace comparable property destroyed in a disaster;
- Property acquired to replace property taken by eminent domain;
- Additions of solar energy systems and fire sprinkler systems; and
- Modifications to make an existing residence more accessible to a severely and permanently disabled person.

The Appendix to this chapter lists all of the amendments to California Constitution, Article XIII A, adopted by the voters since enactment of Proposition 13 in 1978.

The Legislature has also clarified application of the provisions related to change in ownership and new construction, providing that fair market value reassessments are not required for specified transactions, including:

- Transfer of the bare legal title (e.g., when a homeowner pays off the mortgage held by a bank or other financing entity);
- Creations of leases with a term of the creation of less than 35 years (a lease with a term of more than 35 years is considered a 'change in ownership');
- Creations of joint tenancies, when the prior owner is one of the joint tenants in the new joint tenancy;
- Transfers of property between commonly-owned legal entities where the percentage of ownership shares does not change, transfers of property between individuals and legal entities where the percentage of ownership does not change;
- Transfers of ownership interests in legal entities, and transfers of corporate stock so long as no one individual, corporation, partnership or other legal entity acquires more than 50% of the stock;
- Transfers of properties to revocable trusts;
- Alterations or improvements to property which are not major rehabilitation; and

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- Sales of mobilehome parks to the tenants of the parks, either as a whole or transfer of individual rental spaces.

Assessment of Property That is Damaged or Declines in Value. The rules that apply to cases of damage or general decline in value that are not associated with disasters declared by the Governor are as follows:

- Ordinary Circumstances When Value Declines. If property experiences a decline in value for any reason other than a misfortune or calamity, such as a general drop in real estate values, special rules apply regarding that property's assessment value. To the extent that its fair market value is less than its value on the property tax roll, the assessor will reassess the property downward on the next January 1 lien date to reflect its value in its present condition.

However, if the property experiences a decline in value but the market value still is greater than the adjusted base year value on the roll, the factored base year value cannot be reduced.

If the market value later goes up or repairs are made that cause the value to increase, the value on the tax roll will revert at the next lien date to the factored base year value that would have applied if the decline had not occurred.

If restoration construction on the property is significant enough to be classified under Proposition 13 rules as "new construction", the newly constructed portion will be reassessed to fair market value.

- Damage Due to "Misfortune or Calamity". If property has been damaged or destroyed by a misfortune or calamity, the owner may request that the property be reassessed downward immediately to reflect its current value in the damaged condition. This downward reassessment procedure is available only in counties that have adopted authorizing ordinances. It is not necessary for the damage to have occurred as a result of a disaster declared by the Governor. The downward reassessment is accomplished by reducing the factored base year value by the same proportion by which the full market value of the property declined due to the damage.

The downward assessment results in a reduction of property taxes for the assessment year, prorated to reflect the number of months remaining in the year after the damage occurred. The reduced taxes are refunded to the property owner.

In addition, property owners may apply to defer payment of the next property tax installment due following the disaster. The deferral is permitted until the corrected property tax bill, reflecting the reduced value, is issued.

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When the damaged property is restored, it will be reassessed upward. That value will not exceed its prior factored base year value, even though the fair market value may be higher. As in the above situation, if restoration of the property is significant enough to be classified under Proposition 13 rules as "new construction", the newly constructed portion will be reassessed to fair market value.

Two additional relief provisions also are available to owners of property damaged or destroyed by a disaster declared by the Governor. These are described below:

- Exemption From New Construction Reassessment. If real property is substantially damaged or destroyed by a misfortune or calamity, any timely new construction that makes the property substantially equivalent to its state prior to damage or destruction will not result in a reassessment of the new construction. That is, the property can retain its tax value even though new construction has occurred and the new fair market value exceeds the value on the property tax roll. Any portion of the new construction that goes beyond "substantial equivalence" to the state of the property prior to the disaster is reassessed to full market value.
- Transfer of Old Tax Value Upon Relocation. If property is substantially damaged or destroyed by a disaster as declared by the Governor, the base year value may be transferred if the owner constructs or acquires comparable property within the same county within five years after the disaster. The base year value transfer is available to comparable property located in another county only if the county in which the replacement property is located has adopted an ordinance permitting the transfer of value and the time frame is limited to three years. This opportunity to retain the assessed value of the original property is available only if the property sustains physical damage amounting to more than 50% of its full cash value immediately before the disaster. The replacement property must be comparable to the damaged property in size, utility and function. If the market value of the replacement property is more than 120% of the original property, the amount in excess of 120% is added to the transferred factored base year value.

Assessment of Oil and Gas Property. Oil, gas, geothermal or other mineral rights are assessed under Proposition 13 rules. New mineral reserves are added to the roll at their fair market value at the time they are proven to be economic. Thereafter, the value is increased annually by no more than 2% and is adjusted downward in proportion to the depletion of the mineral resource.

7. SUPPLEMENTAL ASSESSMENT ROLL FOR CHANGES IN OWNERSHIP AND NEW CONSTRUCTION

During the first five years after implementation of Proposition 13, some property owners were able to temporarily escape the added tax liability arising from changes in ownership

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or new construction. This occurred as a result of the continuation of pre-Proposition 13 rules establishing tax liability for a fiscal year (July 1 to June 30) based on the value of property as of the preceding lien date.

Prior to July 1, 1983, the law provided that when property was reassessed due to change in ownership or new construction, the additional value was not subject to tax until the fiscal year beginning after the next lien date, which was at that time March 1. Thus, new value could escape taxation for a period of from 4 to 16 months. For example:

- An ownership change in February 1980 was not reflected in higher taxes until the 1980-81 fiscal year, beginning in July 1980, 4 months later.
- An ownership change on March 2, 1980 was not reflected in higher taxes until the 1981-82 fiscal year, beginning in July 1981, 16 months later.
- An ownership change in October 1980 was not reflected in higher taxes until the 1981-82 fiscal year, beginning in July 1981, 10 months later.

However, under legislation that took effect on July 1, 1983, property reassessed upon change of ownership or new construction is now subject to tax immediately, by being placed on a "supplemental assessment roll". The supplemental assessment roll applies only to locally assessed real property subject to Proposition 13 assessment rules and manufactured homes.

The supplemental roll works as follows:

- The added value created by the new construction or ownership change is placed on a separate property tax roll (the supplemental roll) on the date the ownership change occurs or the new construction is complete.
- A tax bill is issued based only on the added value and is prorated for the remaining portion of the fiscal year.
- In the next fiscal year, the entire new assessed value of the property is placed on the regular roll, and there is no supplemental roll liability for that property.

For example, consider a home assessed at \$100,000 in an area where the tax rate is 1.1%. The home is on the regular roll, and the tax for the entire year is \$1,100. On December 31 a room addition is completed which has a fair market value of \$30,000. The supplemental roll tax bill for that year is \$165, computed as follows:

$$\$30,000 \times 0.011 \text{ tax rate} = \$330 \text{ tax} \times 0.50 \text{ (prorating for half of year)} = \$165$$

The \$165 supplemental tax bill is paid in addition to the \$1,100 regular roll bill. The next year, the original value is increased by 2% and combined with the new value of the room addition, and a single regular roll tax bill is issued of \$1,452:

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$$\$100,000 \times 1.02 = \$102,000 + \$30,000 = \$132,000 \times 0.011 \text{ tax rate} = \$1,452 \text{ tax}$$

Pursuant to AB 459 (Oropeza), Chapter 392, Statutes of 2005, sellers of residential real property are required to provide to the purchaser a notice about supplemental property tax assessments.

8. VALUATION OF OTHER PROPERTY

Annual Reassessment to Fair Market Value. Property other than locally-assessed real property is subject to the valuation rules that were in effect for all property prior to Proposition 13. The pre-Proposition 13 rules now apply only to locally-assessed personal property and state-assessed property. These two classes of property are assessed to current fair market value each year, as of the lien date. For locally-assessed personal property, the county assessor has the responsibility for determining fair market value. For state-assessed property, the BOE determines fair market value. In both cases, the tax rate is the same as for all other property: The basic 1% rate, plus any additional rates for debt.

If damage or other factors cause fair market value to decline for these properties, the decline will be reflected in the next annual reassessment. In addition, owners of locally-assessed personal property may apply for immediate downward reappraisal during the tax year after a "misfortune or calamity", if local county ordinances permit. This is the same procedure described in Section 6 above for locally-assessed real property.

Determination of Fair Market Value. Fair market value is defined as the price the property would bring at a sale in the open market by a willing buyer and willing seller, neither of whom is under any compulsion to buy or to sell, and with all the knowledge of the uses the property can be put.

Determination of fair market value is a question of judgment, and the law recognizes that there is no single acceptable appraisal method which assessors should employ to determine fair market value. Some of the most commonly used methods include using the purchase price, looking at sales of comparable properties, capitalizing the income stream (rent) produced by the property, and determining the cost to replace the property.

Recall that for purposes of establishing fair market value of a property that has been purchased, current law requires that the purchase price be presumed to be fair market value, unless there is evidence it would not have sold for that in an open market transaction.

As pointed out earlier in this chapter, the property tax applies only to tangible property. Intangible property is not taxable. Examples of intangibles that are not subject to the property tax include general franchises, patents, and goodwill. However, the courts have recognized that in some instances the presence of intangibles contributes to or enhances the value of real property, in which case they may be reflected in the assessment of property for tax purposes.

Impact of the "4-R" Act on Railroad Valuation. Federal legislation enacted in 1976, the Railroad Revitalization and Regulatory Reform Act (the "4-R Act"), has affected the valuation of state assessed railroad property. The 4-R Act prohibits states from taxing railroad property more highly than other commercial and industrial property in the state. Since California assesses most commercial and industrial property under the "acquisition value" rules of Proposition 13, and railroad property is reassessed to fair market value annually as state assessed property, California must modify its assessment of railroad property to comply with the requirements of the 4-R Act.

BOE has concluded that the effective assessment level of state-assessed railroad property in California is 65.64% of fair market value for the FY 2006-07.

9. LIEN DATE AND "ESCAPED" ASSESSMENTS

All locally-assessed taxable property is assessed annually as of 12:01 a.m. on January 1. This is called the lien date, because on that date the taxes due become a lien against the property until paid. The lien date was changed from March 1 to January 1 commencing January 1, 1997.

All state-assessed property is assessed each year as of 12:01 a.m. on January 1.

An escape assessment is a retroactive, corrective assessment. This assessment rectifies an omission or error that caused taxable property to be under-assessed, or not assessed at all. In most cases, once such an omission or error occurs, the property escapes proper assessment each year thereafter until the underassessment is discovered and corrected. Upon discovery that a property escaped assessment, the assessor is required to appropriately value the property as of the valuation date, record the appropriate value on the roll being prepared, and process any necessary corrections to the current roll. In addition, the assessor is required to process escape assessments for earlier years for which the time to make assessments still is open.

In general, the time period during which assessments may be made remains open for four years beginning on July 1 of each assessment year. To determine the open period for escape assessments, the period is counted back in time from the assessment year of discovery and correction.

For example, a new barn was completed in April 1997 but was not assessed until the assessor discovered it in January 2002. Upon discovery, the assessor should:

- Record (enroll) the appropriate value on the roll being prepared (FY 2002-03). The role for this assessment year closes on July 1, 2002, so this correction would not be an "escape assessment".
- Correct the current roll (FY 2001-02); this is year one of the limitations period.

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- Process escape assessments for all prior years within the statute of limitations (FYs 2000-01, 1999-2000, and 1998-1999 represent years two, three, and four of the limitations period).

As revealed by this example, the assessor is not always able to make a corrective assessment for every year that the property escaped assessment.

10. PREFERENTIAL ASSESSMENT OF CERTAIN PROPERTIES

California Constitution, Article XIII, Sections 3(j) and 8, provides special assessment rules for three categories of property in order to preserve them in their current form and reduce pressure for development. The special assessment rules allow the property to be assessed at the lower of (a) fair market value, (b) the Proposition 13 assessment value, or (c) historical value. The categories of property covered by the special rule are:

- Open space land and agricultural land, the use of which is restricted under Land Conservation Act (Williamson Act) contracts. Examples of open space contracts include scenic highway corridors, wildlife habitats, saltponds, managed wetlands, submerged areas, and recreational areas. The state reimburses local governments for part of the revenue loss resulting from preferential assessments under the Williamson Act. (The Williamson Act is described more fully in Chapter 6G.)
- Timberland.
- Qualifying historical property.

11. TAXPAYER APPEALS OF PROPERTY VALUATION

Taxpayers who disagree with the values placed on locally assessed property by the county assessor may appeal to the county equalization body between July 2 and September 15 of the fiscal year for which the taxes are due. In some counties, the appeals date is extended to November 30.

Under current law, the elected county board of supervisors may sit as the county BOE or may create one or more assessment appeals boards (AABs) to provide that function. According to BOE, there are 19 counties in California in which the board of supervisors also sits as the county BOE. In the remaining 39 counties, AAB members are appointed by a majority vote of the board of supervisors. Each AAB member's term is three years long, and there is no limit on the number of terms an AAB member may serve. Individual terms are staggered in order to ensure that a board will not be comprised of members with no prior AAB experience.

Eligibility requirements for appointment to an AAB vary depending on the size of the county. In counties of less than 200,000 people, the board of supervisors may appoint any person who is believed to possess "competent knowledge of property appraisal and

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taxation". In all other counties, an appointee must have a minimum of five years' professional experience in California in one of the following roles: Certified public accountant or public accountant, licensed real estate broker, attorney, property appraiser accredited by a nationally recognized professional organization, or property appraiser certified by the California Office of Real Estate Appraisers or state BOE.

The roles and duties of the county equalization bodies have been litigated repeatedly. Among the courts' findings: County BOEs are quasi-judicial agencies that function as the fact-finding bodies designated by law to remedy excessive assessments. These boards have the duty to determine the value of locally assessed property and the fairness of its assessment. In discharging this duty, a board's determination regarding the merits of a valuation case are conclusive. Thus, the decision of a county BOE is equivalent to the determination of a trial court and may be reviewed only for arbitrariness, abuse of discretion, or failure to follow the standards prescribed by law.

Rulings of the county equalization body can be appealed to Superior Court, but any Superior Court asked to review a question of fact, which generally is a valuation decision, is limited to inquiry into whether the county board's findings are supported by substantial evidence (i.e., whether the findings are supported by some credible evidence in the administrative record). Thus, the Superior Court sits as an appellate tribunal that reviews the AAB record for reversible error, and taxpayers do not have a right to trial de novo. Over time, three types of reversible errors have been identified: (a) denial of procedural due process to a party by an AAB; (b) utilization of an unlawful appraisal methodology by an AAB; and (c) issuance of findings and/or decisions by an AAB that are not supported by substantial evidence.

Local assessees are provided greater appeal rights on refund actions arising from questions of law than actions arising from questions of fact. In general, questions of fact involve the circumstances surrounding a property's fair market value. Questions of law often involve the determination whether the transfer of a property meets the definition of a change in ownership. Other examples of issues eligible for trial de novo by local assessees include: (a) whether a property qualifies for a specific property tax exemption; (b) whether a particular item is real or personal property; (c) whether a particular statute is constitutional; and (d) whether the proper method of valuation has been used.

Taxpayers who disagree with the values placed on state-assessed property by the BOE may appeal to the Board itself, with further appeal rights to the Superior Court. State assessees are provided trial de novo if they appeal to the Superior Court. Unlike the restrictions placed on courts asked to review questions of fact on locally-assessed real property, the court may make an independent determination of the fair market value of a state-assessed property.

12. PROPERTY TAX EXEMPTIONS

Various categories of property are partly or fully exempt from the property tax. The major exemptions are summarized below.

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Property totally exempted from local property tax includes:

- Most government-owned property.
- Nonprofit religious, charitable, charitable education, and hospital property. This is generally known as the "welfare exemption".
- Household furnishings and personal effects.
- Business inventories, including livestock, held for sale.
- Growing crops. Also, orchards for the first four years after they were planted and vineyards for the first three years after planting.
- Low-value property (generating a tax of less than \$50). The county board of supervisors must authorize this exemption before it is allowed for the county.
- Freight and passenger vessels over a certain size.
- Private railroad cars that are subject to the state private railroad car tax in lieu of the local property tax.

Property partially exempted from local property tax includes:

- The first \$7,000 of full value of an owner-occupied principal residence. This is known as the Homeowners' Exemption. The state reimburses local governments for the loss of revenue attributable to this exemption. (Refer to Chapter 6E, Homeowners' Exemption, for a more detailed discussion.)
- The first \$100,000 or \$150,000 as adjusted for inflation of property owned by disabled veterans and their spouses, with the exempt amount depending on the annual income of the veteran. Beginning in 2006, the exemption amount is adjusted for inflation each year.
- Autos and trucks, which are subject to the vehicle license fee (VLF). Mobilehomes sold new prior to July 1, 1980 are also subject to the VLF in lieu of the property tax; mobilehomes installed after that date are placed on the local property roll and assessed as real or personal property, depending upon the method of attachment to land.
- Standing timber, which is subject to the Timber Yield Tax. Note, however, that the land underlying the timber remains subject to the property tax. Timber land is usually subject to preferential assessment.

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- Racehorses are subject to a special annual Racehorse Tax. This tax is a fixed amount varying by type of racehorse and the age of the horse.
- Personal property of insurance companies is subject to the insurance gross premiums tax in lieu of all other taxes except real property taxes.
- Personal property of banks and financial institutions is subject to a Bank Tax rate in addition to the normal bank and corporation tax. The personal property of banks is not subject to personal property taxes.
- Business records, which are valued based on the value of the paper, rather than the value of the information contained.

13. PROPERTY TAX RELIEF PROGRAMS

The state pays for a variety of property tax relief programs through income tax credits, cash payments made directly to taxpayers, and subventions to local governments as reimbursement for the loss of revenues resulting from property tax exemptions and preferential assessments.

Table 8 illustrates the cost to the state of the major property tax relief programs for FY 2006-07 (the most recent FY for which actual expenditures are known). Most of these programs are described in more detail in Chapter 6, Special Features of the California Tax System.

TABLE 8

Estimated State Expenditures on Property Tax Relief Programs, 2007-08

| | |
|--|-----------------|
| Homeowners' Exemption (subvention to local governments) | \$434.3 million |
| Senior Citizens, Blind & Disabled Homeowner and Renter Property Tax Assistance (direct cash payments to taxpayers) | \$185.3 million |
| Senior Citizens and Disabled Property Tax Deferral (subvention to local governments) | \$ 11.8 million |
| Williamson Act Open Space and Agricultural Land Contracts (subvention to local governments) | \$ 37.3 million |

*Source: 2009-10 Governor's Budget

14. ALLOCATION OF PROPERTY TAX REVENUES TO LOCAL AGENCIES

In 1979, after the passage of Proposition 13, the Legislature enacted a method of allocating the proceeds of the countywide 1% property tax rate to various local entities in each county. The legislation enacting this method was AB 8 of 1979, and the system came to be known as the AB 8 system.

In brief, the AB 8 system ensured that local entities would receive revenues equal to the amount they received in the prior year (the 'base') plus that entity's share of any growth in revenues deriving from assessed valuation in that jurisdiction (the 'increment'). Property tax proceeds from growth, whether due to new construction, changes in ownership, or the 2% inflation factor, accrue only to jurisdictions where the growth occurs.

AB 8 generally allowed local agencies to receive the same share of property tax revenues after Proposition 13 that they received prior to Proposition 13. However, AB 8 also shifted a portion of the property taxes received by schools to cities, counties, and special districts and the state assumed a greater share of education funding. This shift is known as the AB 8 shift or bailout. In effect, California subsidized local governments by passing money through school districts and inflating local governments' property tax revenues.

As part of the package of efforts closing the FYs 1992-93 and 1993-94 budget deficits, the AB 8 shift was partially reduced. Legislation reallocated property tax revenues from cities, counties, and special districts to schools. This shift was accomplished through an Education Revenue Augmentation Fund (ERAF) in each county.

In years following the ERAF property tax shifts, local agencies receive their new base amount plus their share of any growth within the jurisdiction during the past year.

15. ADMINISTRATION

The BOE is charged with developing standards for local assessment practices and also has responsibility for assessing certain utility properties, as described above.

Prior to the enactment of Proposition 13, the BOE had "equalization" powers. That is, the power to require a county to increase assessed values to bring them in line with state standards and assessed values elsewhere in the state. Since the enactment of Proposition 13, BOE no longer has that function. However, BOE is required by statute to monitor local assessment practices and assessed values and report on its findings. If, in its monitoring function, the Board determines that the level of assessment in any county is less than 95% of the assessment level required by law, the county can lose a portion of annual supplemental property tax roll revenues that are earmarked for county administrative costs.

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Local county assessors value all property except the utility and railroad property, private railroad cars, inter-county pipelines, flumes, canals, ditches, and aqueducts assessed by the BOE. The county tax collector collects the property taxes, and the county auditor determines the appropriate allocation of revenues to local entities within each county.

Secured roll taxes are paid to the county tax collector in two installments, which are delinquent if not paid by December 10 and April 10 annually. Unsecured roll taxes are paid in one installment due no later than August 31 annually.

16. CODE

California Constitution, Article XIII and XIII A

Revenue and Taxation Code Sections 1-6000 and Sections 11201-11273

Various sections in Education Code, Government Code, and other Codes.

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APPENDIX

History of Amendments to Proposition 13

| <u>Statewide Ballot</u> | <u>Proposition Number</u> | <u>Summary of Change Adopted</u> |
|-----------------------------|-------------------------------|---|
| June 1978 | 13 | <u>Enactment of Article XIII A.</u> Added Article XIII A to State Constitution, limiting property tax rate, rolling assessments back to 1975-76 level, limiting increases in assessed value, providing for reassessment change in ownership or new construction, prohibiting imposition of new property or other kinds of taxes on real property, authorizing the imposition of local special taxes by 2/3 vote, and making other changes. Most provisions took effect for 1978-79 fiscal year. |
| November 1978 | 8 | <u>Disasters and Declines in Value.</u> Amended Section 2 of Article XIII A, providing that real property reconstructed after a disaster will not be considered new construction if the new market value is comparable to the market value prior to the disaster, and authorizing reduction in assessment of a property in order to reflect substantial damages, destruction or other factors causing a decline in value. |
| November 1980 | 7 | <u>Solar Energy Systems.</u> Amended Section 2 of Article XIII A, authorizing the Legislature to provide that the construction or addition of any active solar energy system will not be considered new construction. |
| June 1982 | 3 | <u>Eminent Domain and Inverse Condemnation</u> Amended Section 2 of Article XIII A, providing that a change in ownership will not include acquisition of property as a replacement for comparable property from which the owner was displaced by eminent domain, acquisition by a public entity, or inverse condemnation. Applied to property acquired after March 1, 1975, for assessments made after June 8, 1982. |

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| June 1984 | 23 | <u>Seismic Safety Reconstruction.</u> Amended Section 2 of Article XIII A, providing that reconstruction or improvement to property constructed of unreinforced masonry bearing wall construction in compliance with local seismic safety ordinances will not be considered new construction during the first 15 years after the reconstruction. |
| November 1984 | 31 | <u>Fire Safety Systems.</u> Amended Section 2 of Article XIII A, authorizing the Legislature to provide that the construction or installation of a fire sprinkler, extinguishing, detection or related system will not be considered new construction. Applies to systems constructed or installed after November 6, 1984. |
| November 1984 | 34 | <u>Historic Structures Rehabilitation.</u> Amended Section 2 of Article XIII A, providing that the addition to, or alteration or rehabilitation of, certified historic structures will not be considered new construction, so long as the structure is the owner's principal residence. |
| June 1986 | 46 | <u>Excess Tax Rates for Bonded Debt.</u> Amended Section 1 of Article XIII A, allowing the levy of a property tax rate in excess of the 1% maximum to pay interest and redemption charges on bonded debt approved by a two-thirds vote of the voters on and after July 1, 1978, for acquisition or improvement of real property. |
| June 1986 | 50 | <u>Replacement Property After Disaster.</u> Amended Section 2 of Article XIII A, allowing the transfer of assessed value from a property substantially damaged or destroyed by a disaster to a comparable replacement property in the same county. Also set forth definitions of "substantially damaged or destroyed" and "comparable." Applies to property acquired or newly constructed on or after July 1, 1985. |

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| November 1986 | 58 | <u>Transfers of Property Within Families.</u> Amended Section 2 of Article XIII A, providing that change in ownership will not include: (1) the transfer of real property between spouses since March 1, 1975; and (2) the transfer of a principal residence and first \$1 million of other real property between parents and children. Also provided that unless specified otherwise, amendments to Section 2 will apply to changes of ownership which occur, and new construction which is completed, after the effective date of the amendment. |
| November 1986 | 60 | <u>Replacement Residences of Senior Citizens, Moves Within Counties.</u> Amended Section 2 of Article XIII A, permitting the Legislature to allow persons over age 55, who sell their residence and buy or build another of equal or lesser value in the same county within two years, to transfer the old residence's assessed value to the new residence. |
| November 1988 | 90 | <u>Replacement Residences of Senior Citizens, Moves Between Counties.</u> Amended Section 2 of Article XIII A, permitting the Legislature to extend the relief allowed by Proposition 60 of November 1986 to replacement residences located in a different county from the original residence, if the county of the replacement dwelling has adopted an ordinance participating in the program. Applied to replacement dwellings acquired on or after a county ordinance is adopted, but not before November 9, 1988. Amended the language adopted in Proposition 58 of 1986 to provide that unless provided otherwise, amendments to Section 2 adopted after November 1, 1988, will apply to changes in ownership that occur and new construction that is completed on or after the effective date of the amendment. |

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| June 1990 | 110 | <u>Replacement Residences of Disabled Persons.</u> Amended Section 2 of Article XIII A permitting severely and permanently disabled persons to transfer the base year value of an original residence to a replacement residence of equal or lesser value under certain circumstances. Also exempts modifications to improve accessibility for the disabled from "new construction" reassessment. This measure's provisions parallel those of Propositions 60/90 with respect to qualifying replacement properties. |
| November 1990 | 127 | <u>Seismic Retrofitting of Existing Buildings.</u> Added a paragraph to Subdivision (c) of Section 2 of Article XIII A allowing seismic retrofitting improvements or improvements utilizing earthquake hazard mitigation technologies to be constructed or installed in existing buildings without being subject to reassessment as new construction. |
| November 1992 | 160 | <u>Spouses of Persons Who Died on Active Duty in the Military.</u> Allows the Legislature to exempt from property taxation, in whole or in part, the home of the spouse of a person who died as the result of a service-connected injury or disease while on active duty in military service unless the home is receiving another real property exemption. |
| November 1993 | 171 | <u>Replacement Property After Disaster.</u> Amended Section 2 of Article XIII A, allowing the transfer of assessed value from a property substantially damaged or destroyed by a disaster to a comparable replacement property located in another county if the county where the replacement property is located has adopted an ordinance permitting the transfer of value. Applies to property damaged on or after October 20, 1991. |

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| June 1994 | 177 | <u>New Construction Exclusion for Disabled Accessibility Improvements.</u> Amended Section 2 of Article XIII A exempting modifications to improve accessibility for the disabled from "new construction" reassessment. This measure's provisions apply to property that is not the principal place of residence of a disabled person. |
| March 1996 | 193 | <u>Grandparent – Grandchild Transfers of Property.</u> Amended Section 2 of Article XIII A excluding transfers of property between grandparents and grandchildren from change in ownership if the parents of those grandchildren are deceased as of the date of the transfer. |
| November 1998 | 1 | <u>Environmental Contaminations.</u> Amended Section 2 of Article XIII A to exclude property acquired or reconstructed as a replacement for property destroyed as a result of environmental contamination cleanup activities from fair market value reassessments. |
| November 2000 | 39 | <u>School Facilities Bonded Indebtedness, 55% Voter Approval.</u> Amended Section 1 of Article XIII A to reduce the voter approval threshold from two-thirds to 55% for school facilities. |

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